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**STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE BILL ANALYSIS**

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| Date Introduced: | 02/11/99, as proposed to be amended | Bill No: | AB 375 |
| Tax: | Sales and Use | Author: | Scott |
| Board Position: | Neutral | Related Bills: | |

BILL SUMMARY:

This bill would allow specified taxpayers, in lieu of reporting their sales and use tax prepayments on an *accrual* basis, to report those prepayments on a *cash* basis.

ANALYSIS:

Current Law:

Under Section 6051 of the Sales and Use Tax Law, sales tax is imposed upon all retailers for the privilege of selling tangible personal property at retail. Civil Code Section 1656.1 provides that whether a retailer may add sales tax reimbursement to the sales price of the property sold to a purchaser depends solely upon the terms of the agreement of sale.

Under Section 2401 of the California Uniform Commercial Code, a sale occurs at the time the seller completes his or her performance with respect to the physical delivery of the goods.

Under Section 6453 of the Sales and Use Tax Law, for purposes of the sales tax, the return must show the gross receipts of the seller during the preceding reporting period. "Gross receipts" is defined in Section 6012 of the Sales and Use Tax Law as the total amount of the sale or lease or rental price of the retail sales of retailers, valued in money, whether received in money or otherwise. This section also specifies that the total amount of the sale or lease or rental price includes, among other things, all receipts, cash, *credits* and property of any kind. Therefore, under existing law, for purposes of reporting sales tax to the Board, payment of sales tax is on an accrual basis, not a cash basis, and is required to be reported and paid with the return for the period in which the sale occurs. The timing of the payment of the sale is not relevant to the timing of a taxpayer's liability for sales tax, nor is the timing of the taxpayer's invoice (except when the timing of the invoice or payment affects the time title to the goods passes to the buyer).

Under existing law, sales and use taxes are due and payable to the state on a quarterly basis, no later than the last day of the month following the end of the quarter. For

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example, applicable tax on sales made between January 1 through March 31 must be remitted to the Board on or before April 30.

Since 1966, the law has required taxpayers whose taxable sales average \$17,000 or more per month (over \$1,200 in tax liability), to report their tax liability on a quarterly basis, with two prepayments required within each quarter. In the first, third, and fourth quarters of the calendar year, the prepayment is due on the 24th day of the next succeeding month for the first two months of each quarter equal to 90% of the tax liability for each month. For example, in the first quarter, 90% of January's liability would be due by February 24, and 90% of February's liability would be due by March 24. There is no prepayment for the last month of the quarter. Rather, all tax liability for March, plus the remaining 10% liability for January and for February would be due by April 30.

The second quarter has a higher and different prepayment schedule as a result of legislation enacted in 1983 to increase cash flow to the State. An amount equal to 95% of April's liability is due by May 24. An amount equal to 95% of May's liability and either 95% of the tax liability for the first 15 days of June or 1/2 of the prepayment for May is due by June 23.

As an alternative to the above, taxpayers who were in business during the preceding year may satisfy their prepayment requirements for the first, third, and fourth calendar quarters by paying an amount equal to 1/3 of the previous year's same quarterly tax liability as their prepayment.

Proposed Law:

This bill would amend Section 6471 of the Sales and Use Tax Law to allow a taxpayer whose average monthly taxable sales are between \$17,000 and \$100,000 to report their prepayments by the due dates prescribed in current law, but on a cash basis rather than on an accrual basis.

The bill would become effective January 1, 2000.

In General:

Currently, less than 14 percent of all taxpayers registered with the Board are required to report their tax liability under the prepayment method. However, these taxpayers report *over 90 percent* of all sales and use tax revenues collected by the Board.

Other taxpayers report their tax liability on a monthly, quarterly (with no prepayments), or annual basis. Taxpayers reporting on a monthly reporting basis represent approximately 6%, quarterly filers amount to approximately 28%, and annual filers amount to approximately 52% of all taxpayers required to report to the Board.

Other than those taxpayers who are currently required by statute to report on a quarterly prepayment basis, the Board administratively specifies the reporting bases that other taxpayers are required to use to file returns and pay their tax liability. In general, those taxpayers that have a monthly tax liability of \$100 or less report on an

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annual basis. Taxpayers with a monthly tax liability of \$101 to \$300 report on a quarterly basis (without prepayments), and those with a monthly tax liability of \$301 to \$1,200 report on a monthly basis. The returns and payments are all due within a month following the reporting period.

Background:

Similar bills have been introduced in the past to address this issue. During the 1997-98 Legislative Session, AB 1672 (Scott) was held in the Assembly Appropriations Committee. The Board voted to support AB 1672, if it was amended to make the prepayment cash reporting basis optional to taxpayers. Also, in the 1993-94 Session, AB 3489 (Andal) passed the Assembly, but died in the Senate Revenue and Taxation Committee.

COMMENTS:

1. **Sponsor and purpose of the bill.** This bill is sponsored by the author and is intended to improve the cash flow of certain businesses who sometimes find it necessary to borrow funds in order to meet the monthly prepayment requirements. Current law requires all retailers to report sales tax liability on an accrual basis; however, because of a retailer's billing and payment cycle, some retailers do not receive payment from customers by the due date of the prepayment. This bill would help to relieve this burden by allowing businesses to defer payment of their sales tax prepayments until they receive payment for the sale.
2. **Bill could impose added record keeping requirements for those retailers that opt to report on a cash reporting basis.** Retailers who opt to use the cash reporting method of reporting their prepayments, who make any credit or installment sales, or who carry revolving credit card accounts, would have to establish a tracking system to account for the tax that is attributable to each partial payment amount made by customers for purposes of reporting their prepayments. Yet, they would continue to be required to file their quarterly return on an accrual basis. In essence, retailers would be required to maintain a dual tracking system – one for making prepayments; one for filing their quarterly tax return. Although this method of reporting could become burdensome for some retailers, the retailer would be allowed the option of reporting under this method.
3. **Proposed repeal of Section 6471 (as amended by Stats. of 1987) would eliminate confusion.** Section 2 of this measure would delete Section 6471, as that section was amended by Section 4 of Chapter 1144 of the Statutes of 1987 (AB 229). The elimination of this section would eliminate confusion. This section is currently inoperative and has been inoperative since its inception because of contingency language that was also incorporated in Chapter 1144 of 1987.

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Specifically, Section 8 of Chapter 1144 provides that the amendments to Section 6471 by that act shall become operative only if the Attorney General certifies that certain provisions of Section 6203 of the Sales and Use Tax Law are legally enforceable. Section 6203 describes various activities which constitute “engaging in business in this state” for purposes of determining whether an out-of-state retailer has sufficient business presence (also known as “nexus”) in California to warrant a use tax collection responsibility. Since the time Chapter 1144 was enacted, some of the provisions of Section 6203 have actually been declared unconstitutional by a Court of Appeal. Consequently, since the Attorney General’s certification could not occur, the repeal of this section would eliminate the confusion associated with it.

COST ESTIMATE:

Administrative costs would be incurred in identifying and notifying affected taxpayers. An estimate of these costs is pending.

REVENUE ESTIMATE:

For the majority of the transactions that would fall under the provisions of this measure, final payment to the taxpayer is estimated to occur on average about forty-five days after the sale. The tax would be remitted to the state on average 30 days later than under current law.

This measure would not result in any loss of *tax* revenue to state or local governments. The sales and use tax law currently includes a deduction for bad debts. Any amounts not eventually collected by the taxpayers would be subject to that bad debt deduction. Under this measure such taxes would never be remitted to the Board.

However, there would be a loss of *interest* income due to the revenue being remitted to the state at a later date than currently. Based on the current interest rate for the Pooled Money Investment Fund of 5.265 percent, if all qualifying taxpayers (those with monthly taxable sales between \$17,000 and \$100,000) opted to use this method of reporting, the combined state and local interest loss would amount to \$543,000 annually.

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